No. 13109

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MARY NEIL and WILLIAM P. NEIL,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the United States District Court for the Southern District of California.

BRIEF FOR THE UNITED STATES.

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Opinion Below.

The opinion of the District Court [R. 24-28] is not reported.

Jurisdiction.

This appeal, in the consolidated cases, involves income taxes in the amount of $5,181.78 for the year 1946 [R. 5, 13], and is taken from a judgment entered June 7, 1951 [R. 32-33]. These taxes were assessed against and paid by the taxpayers upon the filing of their returns on March 15, 1947 [R. 18]. Thereafter amended returns

were filed showing a lesser tax liability and claims for refund of the alleged overpayment of taxes were filed in May, 1949 [R. 23]. The claims were not acted upon within six months of their filing and suits for refund were filed on August 4, 1950 [R. 3-5, 11-13], in conformance with Section 3772 of the Internal Revenue Code. The District Court took jurisdiction of the cases under Section 1346, 28 U. S. C. Notice of appeal was filed on July 30, 1951 [R. 46], pursuant to Section 1291, 28 U. S. C., upon which the jurisdiction of this Court is based.

Questions Presented.

1. Whether or not the District Court Judge who tried and decided this case was disqualified from participation therein under Section 455, 28 U. S. C., because he had been the Collector of Internal Revenue when the taxes involved were paid.

2. Whether or not where, because of litigation in a subsequent year, a partner does not recover part of his share of the net assets in the dissolution of a partnership, he is entitled to adjust his distributive share of the net income of the partnership in the year of dissolution.

Statutes and Regulations Involved.

The statutes and regulations relating to this case are found in the Appendix, *infra*.

Statement.

1. The facts relating to the question of the propriety of Judge Westover's participation in this case may be summarized as follows:

The income tax returns of the taxpayers for the year 1946 were filed with the Collector of Internal Revenue for the Sixth District of California. At all times between July 1, 1943, and October 31, 1949, Harry C. Westover was the Collector of Internal Revenue for the Sixth District of California. [R. 18.] At some time after the latter date, although the date is not disclosed by the record, Harry C. Westover was appointed and took office as United States District Judge for the Southern District of California. After that date he did not at any time act as Collector of Internal Revenue. [R. 4, 9.]

The complaints in these cases were filed in the District Court for the Southern District of California on August 4, 1950. [R. 3-8, 11-13.] At preliminary hearings in the cases, on January 8, 1951, held before Judge Westover, counsel for the taxpayers directed the attention of the Judge to the fact that the taxes involved were assessed while he was Collector of Internal Revenue. [R. 52.] Judge Westover stated that he knew nothing about the cases but he said that if there were any objections to his sitting in the trial he would transfer the cases. [R. 52.] He asked counsel for both parties whether they were willing that he should try the issues and both agreed he should do so. [R. 52.] Later, at the opening of the trial on April 2, 1951, the Judge himself raised the question again as to his participation in the trial of the cases and again counsel for the parties consented and counsel for the taxpayers stated: "I again have no objection." [R. 54.]

On June 12, 1951, after the cases had been decided and judgment had been entered, the taxpayers filed a motion to vacate judgment and a motion for a new trial both alleging Judge Westover was disqualified in the cases under Section 455, 28 U. S. C. [R. 34, 37.] The motions were heard [R. 45], argued [R. 55-56], and denied. [R. 46, 56.] In this Court taxpayers assign error in that action.

2. The facts relating to the question of the taxability of the taxpayers' share of the 1946 net proceeds of the partnership, as stipulated or as found by the Court, may be summarized as follows:

The taxpayer William P. Neil was at all times between December 1, 1943, and September 30, 1946, a partner with LeRoy D. Owen in a real estate brokerage business operating under the name of "LeRoy D. Owen Company." [R. 18, 29.] The partnership was at no time licensed to do a real estate brokerage business but all during the period of the partnership Mr. Owen held a real estate broker's license, doing business as "LeRoy D. Owen Co.," and the brokerage business of the partnership was conducted under that license. [R. 19, 29.] The partnership was dissolved on September 30, 1946 [R. 21, 30], and the partners agreed between themselves as to the distribution of partnership assets. [R. 21-22.] In this distribution of assets Mr. Neil received $3,505.87 in cash and shares of stock carried upon the partnership books at $23,358.59. [R. 21-22.]

During the year 1946 the partnership had ordinary net income of $63,719.67 [R. 20, 30], of which Mr. Neil's share was, pursuant to the articles of partnership, $28,-568.21, and this amount, divided equally under the com-

munity property laws of California, was included in the individual income tax returns of William P. Neil and his wife Mary Neil. [R. 18, 30.] Individual income taxes upon one-half, or $14,284.10, were paid by each taxpayer. [R. 18.]

On March 3, 1947, William P. Neil brought suit against LeRoy D. Owen in a California court for the recovery of certain assets of the partnership due to Neil by virtue of the dissolution agreement. [R. 22, 25, 30.] The action ended in February, 1949, in the Superior Court of California, by judgment in favor of Mr. Owen [R. 22, 30], and an appeal by Mr. Neil was dismissed after the payment of $1,000 by Mr. Owen to Mr. Neil. [R. 22.] The decision of the Superior Court was rendered in favor of Mr. Owen because Mr. Neil was not a licensed real estate broker and approximately 95% of the business of the LeRoy D. Owen Company was commissions on real estate sales. [R. 25.]

The partnership return for 1946 was filed on February 18, 1949, and showed a partnership net income of $63,719.67 [R. 20], and in May, 1949, the taxpayers filed amended individual tax returns [R. 4, 9, 12, 14, 23] alleging the distributive share of the partnership income of Mr. Neil to be $19,456.39. [R. 30.] Claims for refund of overpayment of taxes on that basis were filed by the taxpayers [R. 30] and, not having been acted upon within six months, suits for refund were brought. [R. 5, 10, 13, 15.] Those suits were decided in favor of the United States [R. 32-33], and the taxpayers' appeal from that decision followed. [R. 46.]

Summary of Argument.

1. There is manifestly no merit to the taxpayers' contention that Judge Westover was disqualified to pass upon the motions filed in this case or to try the issues in the District Court. When the question of his prior office as Collector of Internal Revenue was raised at preliminary hearings he stated he knew nothing of the cases or of any reason why he would be biased or prejudiced for or against either party, but he consented to transfer the cases if either party objected to his participation. Both parties on two different occasions consented to his trial of the cases, and not until after his decision was the question of his disqualification raised under Section 455, 28 U. S. C.

Whether any of the provisions of that section are mandatory, a matter for judicial determination, is of no consequence. The connotation of the term "of counsel" in the statute clearly does not include administrative and ministerial duties such as are performed by a Collector of Internal Revenue and Judge Westover was not disqualified on that condition. Moreover, he had no substantial interest in the cases. They were suits against the United States and the Judge would not, therefore, be affected by the decision. Judge Westover was not, therefore, disqualified on the "substantial interest" condition in the statute. The other conditions of the statute are not in point and there is thus no basis to sustain the taxpayers' attack upon Judge Westover's participation.

2. The taxpayers' contention that they are not subject to tax upon the full amount of Mr. Neil's distributive

share of partnership net income for 1946 because of subsequent litigation between the two partners ignores the actual situation in this case. There is no dispute whatever that the partnership had net income for 1946 up to the date of its dissolution and the amount thereof is not in dispute. Under the applicable law the taxability of Mr. Neil's distributive share is certain whether or not he withdrew it from the business and the record is silent on that point.

The taxpayers, however, assert that because Mr. Neil was unable to recover in the suit against Mr. Owen the taxes are not due, overlooking entirely the fact that the suit against Mr. Owen had no bearing upon partnership net income and each partner's distributive share. It was a suit to enforce collection from Mr. Owen of part of partnership assets due Mr. Neil in the partnership's dissolution and liquidation. The net income of the partnership had to be determined and certain before that dissolution and liquidation could take place and whether those assets included part of net earnings was a different matter. Moreover, the state court did not say that the partnership did not have income, it merely held that California courts could not be used to collect net assets upon dissolution under California law. In this connection, in any event, the rule is well established that state law cannot be controlling in matters of federal taxation.

ARGUMENT.

I.

The Trial Judge Was Not Disqualified to Try This Case nor to Pass Upon the Motion to Vacate Judgment Therein.

The taxpayers in this case, in this Court, attack the propriety of Judge Westover's participation in it in the District Court under Section 455, 28 U. S. C., Appendix, *infra.* The caption to this attack in the brief (p. 10) states that Judge Westover was disqualified to rule upon taxpayers' motion to vacate the judgment but in the argument it is stated that "the mandatory disqualification of the said trial judge to try the case, or to pass upon the motion to vacate the judgment, is apparent." (Br. 11.) It is not contended that the lack of clarity as to the extent of the asserted disqualification is consequential so far as the result of the case is concerned, but in line with the motion to vacate judgment [R. 34], the points and authorities filed therewith [R. 34-36], and the motion for new trial [R. 37] it would appear that the attack upon Judge Westover's participation is all inclusive.

There is manifestly no merit to the taxpayers' contention. The point actually appears first in the complaints filed in the District Court which alleged facts [R. 3-4, 11-12], admitted in the answers [R. 9, 14], relating to Judge Westover's prior office as Collector of Internal Revenue for the Sixth District of California, but in proceedings prior to the actual trial of the case it was agreed that Judge Westover should sit.

In these proceedings, set out in the record, Judge Westover, relying upon the pleadings, actually raised the question of his participation. [R. 52-54.] At the proceed-

ings on January 8, 1951, when taxpayers' counsel directed attention to Judge Westover's prior office, the Judge asked counsel whether they were willing for him to try the case. [R. 52.] The question was put to counsel after Judge Westover had said he knew nothing at all of this case but that if counsel had any objection to his sitting he would be glad to transfer the case to another court. [R. 52.] Taxpayers' counsel replied to Judge Westover's question that he was willing to have Judge Westover try the issues.

Again on April 2, 1951, the date on which the case was tried, Judge Westover said [R. 53-54]:

> Before proceeding with this case, I have raised this issue before, and you said you were perfectly willing to continue with the matter. I also want to raise it again, because I don't want you to come in a little later on and say you have been penalized in any way. It appears from the pleadings that when this income tax return was originally filed, I was Collector of Internal Revenue. I said once before I never heard of the case, don't know anything about the case. I don't know any reason in the world why I should be biased or prejudiced for or against either party, but I am bringing it to your attention right now.

In response to this statement by Judge Westover, taxpayers' counsel said again he had no objection, as did Mr. Mitchell for the Government, and Judge Westover said he wanted that situation to appear in the record because he did not want anyone to raise a question about it a year or two hence. The situation was discussed again

at the hearings on the above-mentioned motions on July 16, 1951. [R. 55-56.] It is, perhaps, significant that the taxpayers do not set out the foregoing facts in their brief nor allude to them in any way.

Section 455, 28 U. S. C., is a revision of what was formerly Section 20, Judicial Code. It, however, removes the procedural aspects of the prior provision and imposes a duty upon a judge to disqualify himself in cases under specified conditions. Two of the conditions are matters especially within the knowledge of the judge; that is, whether he has a substantial interest in a case, and whether he is so related to or connected with any party as to make it improper, in his opinion, to sit in a case. The two other conditions are matters of public record; that is, whether he has been of counsel or a material witness in a case. Whether any of these conditions, as taxpayers argue, may be said to be mandatory, to preclude a judge's participation in a case is a matter for judicial determination.

We have found but one case arising under Section 455, that of *United States v. Maher,* 88 Fed. Supp. 1007 (Me.) but there are several arising under the earlier statutory provision relating to the interest of judges in particular litigation. In the *Maher* case, it was held that Section 455 compels a judge of a United States District Court to disqualify himself whenever he has been of counsel for either party in a case before him. That decision, which relied upon *United States v. Vasilick,* 160 F. 2d 631 (C. A. 3d), implies that if a judge sat in a case in which

he had been of counsel there might be grounds for reversible error but it does not otherwise label any of the conditions of Section 455 as mandatory. While *United States v. Vasilick,* and *In re Fox West Coast Theatres,* 25 Fed. Supp. 250 (S. D. Calif.), affirmed, 88 F. 2d 212, 226 (C. A. 9th), certiorari denied, 301 U. S. 710, rehearing denied, 302 U. S. 772, indicate classification under the earlier provision, other decisions generally have avoided such classificaton (*Utz & Dunn Co. v. Regulator Co.,* 213 Fed. 315 (C. A. 8th)); have recognized (1) that the disqualification might be waived (*Utz & Dunn Co. v. Regulator Co.; Borough of Hasbrouck Heights, N. J. v. Agrios,* 10 Fed. Supp. 371 (N. J.)), and (2) that a judge's connection with a case might be so remote or trivial as not to constitute a basis for disqualification (*Utz & Dunn Co. v. Regulator Co.; Voltmann v. United Fruit Co.,* 147 F. 2d 514 (C. A. 2d)). The rule of these other cases might appropriately be applied to Section 455 so as to deny the position taken by the taxpayers in this case.

In any event, however, taxpayers' contention avails them nothing here. Both the *Maher* case, *supra,* and the *Vasilick* case, *supra,* involved the question of a judge's participation in proceedings where at the time the defendant was tried and convicted and sentenced the judge had been the United States Attorney. Pointing to other sections of the Judicial Code (Sec. 771, Rev. Stat. in the *Vasilick* case, *supra,* and Sec. 507, 28 U. S. C., in the *Maher* case, *supra*), the courts said that there was no

doubt that a United States Attorney is "of counsel" for the United States in all criminal cases in his district. Those cases do not compel any conclusion that their rule disqualified Judge Westover in the instant case and, indeed, the taxpayers do not press any argument along that line in their reliance upon the *Vasilick* case. That would indicate that they recognize a wholly meritorious distinction between that case and their position here.

As a matter of fact, they appear to be uncertain as to whether any condition in Section 455 applies to Judge Westover's participation in this case. They assert that because the Judge had been the Collector of Internal Revenue he had a "substantial interest" and had "been of counsel" [Br. 11, R. 36] but in the next sentence they state, more nearly accurately, that the Judge had been an employee and agent of the United States in the asessment and collection of income taxes. Being "of counsel" and being an "employee and agent" are hardly synonymous in the connotation of the statute. Judicial notice of the usual and ordinary meaning of the term "of counsel" would recognize the distinction between representation of a client in or out of court as counsel, and the performance of ministerial and administrative acts as a Collector of Internal Revenue. That recognition precludes any disqualification of a judge founded upon the "of counsel" condition in Section 455. It is wholly without merit here.

Nor has it been or can it be shown that Judge Westover had any "substantial interest" in the instant cases. He stated on two different occasions that he knew nothing of

the cases [R. 52, 54]; a point of significance when it is borne in mind, as we have pointed out above, that that is one of the conditions in the statute the existence of which is especially within the knowledge of the judge. Moreover, the outcome was of no consequence whatever to Judge Westover. The suit was one against the United States from which he would derive no benefit however it was decided. Without conceding that the distinction is in any way material, the situation might be different if the suit had been against Judge Westover as Collector of Internal Revenue when a certificate of probable cause would have to be made under Section 2006, 28 U. S. C., but that is not the situation here.

The result is that the attack upon the propriety of Judge Westover's participation in the case has no substance whatever. None of the other conditions of Section 455 are relied upon by taxpayers and indeed they could not be. If counsel for the taxpayers could agree to his sitting when the question was first raised there was no change in the situation when a decision adverse to the taxpayers was rendered. Here, as was said in the decision in *Voltmann v. United Fruit Co., supra,* the judge's connection with the instant case prior to its trial was so remote and trivial, actually only nominal, that the fault found by the taxpayers is hardly more than an attempt to bolster the disqualification motion and amounts but to an overemphasis of the trivial. As such it deserves no more endorsement by this Court than was given it in that case.

II.

The District Court Was Correct in Holding and Deciding That the Taxpayers Were Taxable Upon William P. Neil's Share of the Partnership's Ordinary Net Income for 1946 Regardless of Events in Subsequent Years.

The section of the Internal Revenue Code applicable to this case, that is, Section 182(c), Appendix, *infra,* provides that in computing the net income of a partner, his distributive share of the partnership's ordinary net income shall be included in his gross income whether or not distribution is made to him. Inasmuch as individuals carrying on business in the form of a partnership are, under Section 181 of the Internal Revenue Code, Appendix, *infra,* liable for tax only in their individual capacity, the reason for that provision is that, when the partnership's tax year is ended, the individual partners have constructively received their share of its ordinary net income whatever they do with respect to withdrawing it out of the business in cash or otherwise. That situation has been recognized in *Bourne v. Commissioner,* 62 F. 2d 648 (C. A. 4th), certiorari denied, 290 U. S. 650, and cases there cited; *Faesy v. Commissioner,* 1 B. T. A. 350; *Peterson v. Commissioner,* 27 B. T. A. 1009, and *Curtis v. Commissioner,* 3 T. C. 648, 662. In the *Faesy* case, *supra,* it was said that the fact that subsequent disagreement of one partner with the other, and litigation in connection therewith, has precluded the partner from ever receiving any of his money does not lessen his taxability upon it.

Applying the law and those decisions to the facts in this case there is no doubt that the District Court was correct in holding and deciding that the taxpayers were taxable

in 1946 upon William P. Neil's share of the ordinary net income of the LeRoy D. Owen Company partnership. There is no dispute that William P. Neil and LeRoy D. Owen were partners in that company from December 1, 1943, through September 30, 1946, and that fact is stipulated. [R. 18, 29.] Nor is there any dispute that the partnership had net income for the year 1946. [R. 20, 25, 30.] Moreover, it is stipulated that William P. Neil and his wife, under the community property laws, included in their 1946 returns the amount of $28,568.21 as William Neil's share of the net income from the partnership for that year [R. 18], and it was found as a fact by the court that that amount was William P. Neil's distributive share. [R. 30.] The record is completely silent with respect to withdrawals of that amount, but in any event taxability on it was thus clearly fixed.

The taxpayers, however, attempt to avoid that correct and proper decision by reliance upon unrelated events occurring in subsequent years [R. 23, 25] and contend that because of those unrelated subsequent events the District Court rendered an erroneous decision. That contention can not prevail. The rule that income taxes must be computed and paid upon an annual basis is well established in income tax law (*Burnet v. Sanford & Brooks Co.,* 282 U. S. 359, 363, 365; *Dixie Pine Co. v. Commissioner,* 320 U. S. 516, and *Security Mills Co. v. Commissioner,* 321 U. S. 281) but the taxpayers urge this Court to ignore that rule by accepting unrelated propositions which have no place in the circumstances in the instant case.

We say the events upon which the taxpayers rely are unrelated because they did not pertain to the question of what was Mr. Neil's distributive share of the net income

of the partnership for 1946. The stipulation of facts set out that the net income of the partnership for 1946 was $63,719.67 [R. 20]; that same amount is found by the Court as the net income of the partnership for 1946 [R. 30, 31] and in their brief in this Court the taxpayers state: "There is no dispute between the parties with respect to the 'earned' income of the partnership for the year 1946, which was $63,719.67." (Br. 19.) Under the partnership agreement Mr. Neil's distributive share was one-half of that amount less salary to Mr. Owen of $700 per month. That amount less $6,300 (salary for 9 months at $700) leaves $57,419.67, one-half of which is $28,709.88, and that amount, with an adjustment of $141.67, was Mr. Neil's distributive share upon which taxes had to be paid.

There can be no question upon that point but the taxpayers refer to the litigation in 1947 through 1949 to deny that tax is due upon that amount. The litigation between Mr. Neil and Mr. Owen had nothing whatever to do with the partnership's net income. It was litigation by which Mr. Neil sought to recover from Mr. Owen "some of the assets of the copartnership which were to have been delivered to him upon its dissolution" [R. 25]; it was a suit "for the recovery of certain assets of the partnership due to Neil by virtue of the dissolution agreement." [R. 30.] The income was earned and Mr. Neil's distributive share was determined and certain before any distribution of assets in liquidation of the partnership was or could be made, and taxes are due and payable under the Internal Revenue Code and the decided cases whether or not it was distributed to him.

That is the actual and simple situation in this case. The taxpayers, however, confuse distributions made to William

P. Neil upon dissolution of the partnership on September 30, 1946, with his distributive share of partnership ordinary net income for 1946 and during the life of the partnership. (Br. 12, 13.) Whatever may have been the ultimate relationship, if any, between the distribution of assets upon dissolution and the distributive share of partnership net income for 1946, the fact remains that this case in the District Court and in this Court involves merely the question of taxability of Mr. Neil's share of the partnership net income for 1946. That question can not be complicated by computations as to what Mr. Neil had received from the partnership during its life.

The taxpayers further attempt to avoid tax liability by reliance upon provisions of the California Business and Professions Code, and the decision of a California court concerning Mr. Neil's ability to collect from Mr. Owen his part of partnership assets upon dissolution. This is the subsequent event upon which they rely to defeat taxes due and payable. As is pointed out above, this case involves income taxes for 1946, derived from the operation of a partnership to September 30 of that year. In March, 1947, Mr. Neil sued Mr. Owen for recovery of amounts due upon liquidation and not until 1949, three years after the partnership was dissolved, did Mr. Neil find out that he could not, under California law, recover assets to which he was entitled upon dissolution of the partnership. In so deciding the California court did not say that Mr. Neil did not earn income from the partnership in 1946. It merely held he could not collect assets from his former partner through the California courts.

This situation is aptly pointed up in the opinion of the District Court Judge when he states that even if the Business and Professions Code of California provides that

it may be unlawful to divide a real estate agent's or broker's commission with a non-licensed person and that California courts may not be used for the collection of fees and compensation under that circumstance, that Code does not declare that fees or compensation of an unlicensed broker are not income. [R. 27.] It could not so declare from the standpoint of federal income taxation and in reliance upon that law and that decision the taxpayers are met by another well-established rule that the operation of federal taxing statutes is not subject to state law. (*Burnet v. Harmel,* 287 U. S. 103, 110; *Weiss v. Wiener,* 279 U. S. 333, 337; *Morgan v. Commissioner,* 309 U. S. 78, 80, and *California Iron Yards Co. v. Commissioner,* 47 F. 2d 514 (C. A. 9th).) The simple fact is that even if the partnership agreement were not valid under the California law, and even if Mr. Neil could not enforce collection of his share of partnership net assets upon dissolution in its courts, the partnership existed from December 1, 1943, to September 30, 1946, and had net income and the taxpayers are taxable upon Mr. Neil's distributive share in 1946 whether or not it was ever distributed to him.

Moreover the taxpayers further attempt to avoid the correct application of Section 182(c) of the Internal Revenue Code by a misapprehension and misapplication of the "claim of right" rule to income as used in *United States v. Lewis,* 340 U. S. 590, rehearing denied, 341 U. S. 923 (Br. 16-17), and the definition of "earned income" for a particular purpose. (Br. 19.) The District Court Judge in using the latter term in his opinion [R. 26, 28] was not referring to receipt. He was referring to the incidence of tax and cited *United States v. Lewis, supra,* not because of its discussion of the claim of right doctrine,

however applicable it may have been there, but to support the correct theory that whether or not Mr. Neil received his distributive share in 1946 it was nonetheless earned net income of the partnership upon which, under Section 182(c), income tax had to be paid by the partners in their individual capacity. In *United States v. Lewis, supra,* the Supreme Court said income taxes must be paid upon income received during an annual accounting period. Mr. Neil constructively received his share of the partnership net income for 1946 when it was dissolved and tax is due upon it for that year regardless of the litigation in subsequent years which denied him the right to collect from Mr. Owen his share of unpaid partnership assets.

It is noteworthy that taxpayers use the "claim of right" doctrine to conclude that the income of the partnership was that of Mr. Owen. (Br. 16.) He is not the taxpayer here. The doctrine can, however, be used conversely to show that the net income was income of the taxpayers. It is also noteworthy that despite so contending and despite their contention that under California law the partnership was invalid and Mr. Neil had no rights to any income, the taxpayers apply the "claim of right" rule to admit that the amounts paid to Mr. Neil in 1943, 1944 and 1945 were proper. (Br. 18.) If that were so in those years it was also so in 1946 and that in effect is what the District Court has decided.

In relying upon the definition of "earned income" in Section 116(a)(3) of the Internal Revenue Code, Appendix, *infra,* the taxpayers ignore completely the fact that the definition of that term there given is for the purpose of computing what income from sources outside of the United States is excludable from gross income of a taxpayer and is exempt from taxation. The definition

has no other purpose or intent and can not be lifted from the context of the Internal Revenue Code to be used to label as not taxable income that part of the net proceeds of partnership operation which that Code elsewhere includes in income. See Sections 22(a), 181, 182(c), Internal Revenue Code, Appendix, *infra*.

The taxpayers rely upon *Reinschmidt v. Commissioner,* 28 F. 2d 660 (C. A. 5th). It is not in point in this case. There the taxpayer sought to adjust his taxes because he had erroneously included as exclusively his income proceeds from the sale of partnership property. When the other partners objected he adjusted his books to include only his share and this was permitted correctly to reflect his income for the taxable year. Here there is no such situation. The taxpayers here attempt to deny that their share of partnership net income is taxable in the year earned and that may not be done under applicable provisions of law.

The decision of the District Court in this case, on the other hand, is in accordance with the rule of *Bourne v. Commissioner, supra.* While in that case no litigation was involved, and the situation was otherwise different from this case, there the partner was nonetheless held to be subject to the tax upon his share of partnership net proceeds even though they were not distributed to him and were retained by other partners. See in this connection also the case of *Faesy v. Commissioner,* 1 B. T. A. 350, in which, as pointed out above, it was held that despite disagreement between partners and litigation in connection with the payment of the net proceeds from the operation of a partnership the partner was taxable upon his share even though it was not paid to him.

Conclusion.

The decision of the District Court is correct and should be affirmed.

Respectfully submitted,

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January, 1952.

APPENDIX.

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.* — "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * * * * * *

(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 116. EXCLUSIONS FROM GROSS INCOME.

In addition to the items specified in section 22(b), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(a) [as amended by Section 148, Revenue Act of 1942, c. 619, 56 Stat. 798, and Section 107, Revenue Act of 1943, c. 63, 58 Stat. 21] *Earned Income from Sources Without United States.*—

* * * * * * * * *

(3) *Definition of earned income.*—For the purposes of this subsection, "earned income" means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the

compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered.

* * * * * * * * *

(26 U. S. C. 1946 ed., Sec. 116.)

Sec. 181. Partnership Not Taxable.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. (26 U. S. C. 1946 ed., Sec. 181.)

Sec. 182. Tax of Partners.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * * * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U. S. C. 1946 ed., Sec. 182.)

Sec. 183. Computation of Partnership Income.

(a) *General Rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b) and (c).

(b) [as amended by Section 150, Revenue Act of 1942, *supra*] Segregation of Items.—

* * * * * * * * *

(2) *Ordinary net income or loss.*—After excluding all items of * * * gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

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(26 U. S. C. 1946 ed., Sec. 183.)

28 U. S. C.:

Sec. 455. Interest of Justice or Judge.

Any justice or judge of the United States shall disqualify himself in any case in which he has a substantial interest, has been of counsel, is or has been a material witness, or is so related to or connected with any party or his attorney as to render it improper, in his opinion, for him to sit on the trial, appeal, or other proceeding therein.

Sec. 2006. Execution Against Revenue Officer.

Execution shall not issue against a collector or other revenue officer on a final judgment in any proceeding against him for any of his acts, or for the recovery of any money exacted by or paid to him and subsequently paid into the Treasury, in performing his official duties, if the court certifies that:

(1) probable cause existed; or

(2) the officer acted under the directions of the Secretary of the Treasury or other proper Government officer.

When such certificate has been issued, the amount of the judgment shall be paid out of the proper appropriation by the Treasury.

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.182-1. *Distributive Share of Partners.*—(a) Each partner is required to include in his return for his taxable year within which or with which the taxable year of the partnership ends, whether or not distributed:

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(3) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(b) If separate returns are made by the husband and wife domiciled in a community property State, and the husband only is a member of a partnership, the part of his distributive share of gains and losses of the partnership from sales or exchanges of capital assets or the part of his distributive share of ordinary net income or ordinary net loss, which is, or is derived from, community property should be reported by the husband and by the wife in equal proportions. * * *